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SUPREME COURT, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM 1970

No. 837

CRESTA CORPORATION, S.A.,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT ON BEHALF OF CRESTA CORPORATION, S.A.

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To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioner, Cresta Corporation, S.A., prays that a writ of certiorari be issued to review the decision and judgment of the United States Court of Appeals for the Second Circuit entered in the above case on July 14, 1970, affirming an order of the Tax Court of the United States entered July 7, 1969.

Opinions Below

The opinion of the Court of Appeals for the Second Circuit is not yet reported. A copy thereof is appended hereto (*infra*, P. 4a). The opinion of the Tax Court of the United States is reported at 30 T.C. 145 and a copy thereof is appended hereto (*infra*, P. 22a).

Jurisdiction

The judgment of the Court of Appeals for the Second Circuit was made and entered on July 14, 1970, and a copy thereof is appended hereto (*infra*, P. 33a). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and 2101(e) and Rule 19.1(b) of this Court.

Statutes Involved

Internal Revenue Code, 1954:

Section 368(a)(1)(D)

Regulations:

Internal Revenue Code, 1954

Section 1.368-1(b)

Section 1.368-2(g)

The text of these statutes is set forth in the Appendix hereto (*infra*, P. 1a).

Questions Presented for Review

1. Do the business reorganization provisions of the Internal Revenue Code apply to a transfer of liquid non-operating assets of a personal holding company not engaged in any trade or business to another personal holding company which does not engage in any trade or business after the transfer?

2. Whether the liquidation of a corporation after the conclusion of its business activities by the distribution of all of its assets to its sole shareholder, an individual, and the later transfer by such individual of the liquidated assets, together with other securities to another corporation constitutes a reorganization within the judge made reincorporation doctrine and the meaning of Section 368 (a)(1)(D) of the Internal Revenue Code.

Statement of the Case

The basis for jurisdiction in the Tax Court of the United States was the assertion of an income tax deficiency by the Commissioner of Internal Revenue against the petitioner for the year ended December 31, 1957 and the filing by the petitioner of a timely petition with the Tax Court for a redetermination of the asserted deficiency.

This petition involves a series of transactions in which Werner Abegg, a Swiss citizen, liquidated Hevaloid, a wholly-owned corporation, and transferred all its assets, plus other securities in substantial amount, to another corporation which engaged in no business activity. The basic facts, which are not in dispute, are as follows:

Hevaloid Corporation was organized under the laws of Delaware in 1938. All its issued stock, 250 shares, was held by Abegg. It owned industrial patents and machinery which it leased to various American corporations. In 1955 the patents expired and it sold the machinery. In 1956 and 1957 it was a personal holding company; its assets consisted exclusively of cash, securities, receivables, and rights in a motion picture "Guest in the House." In 1957, Robert A. Cavin, a close associate and business adviser of Abegg for many years, was its president.

On March 28, 1957, Hevaloid adopted a plan of complete liquidation and dissolution. A certificate of dissolution was filed on April 18. During April and May it sold stock in four publicly owned corporations for $1,671,341, which it deposited in the New York Trust Company. These sales represented a gain of $932,701. Hevaloid reported them in its 1957 income tax return but claimed that the gain was not to be recognized under I.R.C. §337. On May 1 and 2 it drew checks to Abegg on its account at New York Trust Company aggregating $1,660,936. On May 7 it delivered to Laird & Co., a New York brokerage firm, for Abegg's account, certificates and stock powers for 7,470 shares of Brazos River Gas Company, 2,720 shares of Medallion Petroleum Limited, and 13,692 shares of Producing Properties, Inc. On May 23 it directed Laird & Co. to transfer from the account of Hevaloid to the account of Abegg 1,945 shares of Magma Copper Company and 2,600 shares of Signal Oil and Gas Company; on the same day it also transferred to Abegg its interest in a loan receivable from Perosa Corporation and in the motion picture. The final step in its liquidation was taken in December 1957 by drawing to Abegg a $32,156 check on another bank. Abegg deposited all these checks in his account at Bankers Trust Company.

Cresta Corporation, S.A., originally known as Suvretta Corporation, S.A., was incorporated in Panama in 1941 but remained inactive. On May 7, 1957, it issued 1,000 shares of stock to Abegg in return for cash and other assets, as follows: On May 7, 1957, Abegg issued to it a $1,500,000 check on his account at Bankers Trust Company, $250,000 of which was considered a demand loan and $1,250,000 as part payment for stock. On May 24, Laird & Co., on Abegg's instruction, transferred to Cresta in further payment the five securities that Hevaloid had

ordered it to transfer to him earlier that month. The fair market value of each security exceeded its adjusted basis; the aggregate excess was $262,520. The same day Abegg transferred stock of Illinois Central R.R., Olin Mathiesen Chemical Corporation, additional common shares and a note of Brazos River Gas Company, preferred stock and bonds of Producing Properties, Inc., 1,000 shares of Perosa Corporation, which were regarded as value less, and 3,000 shares of Meridan Corporation, a Rhode Island corporation in which he owned 50% of the stock and Cavin 10%. Meridan had a net worth of $2,510,673 as of December 31, 1957. Nearly sixty per cent of this represented a piano business in Michigan; it also had an interest in an operating company in Chicago and later acquired one in a company in Tacoma, Washington. On June 8 Abegg transferred to Cresta the interest in "Guest in the House" and in the debt from Perosa Corporation which Hevaloid had assigned.

The directors of Cresta, including Abegg and Cavin, met on February 6, 1958, in New York and resolved to qualify to do business in that state, to accept cash and securities from Abegg as contributions to capital, and to borrow an additional $250,000 from him on open account. Abegg drew a check for $400,000 and on February 26, 1958, contributed stock as follows:

	Adjusted Basis	*Fair Market Value*
50,680 shares Brazos River Gas Co.	$ 55,850	$101,360
4,250 shares General American Oil Co.	91,653	110,578
12,650 shares Magma Copper Co.	1,300,971	449,075
	$1,448,474	$661,013

Cavin was Cresta's sole employee in its fiscal years ending February 28, 1958 and 1959 and February 29, 1960. He maintained watch over its holdings, especially those in Meridan, and investigated at least a dozen opportunities for investing Cresta's funds with a view to acquiring the stock or assets of a going business, although no acquisitions were made. In these years Cresta paid salaries to Cavin aggregating $46,750, and also some $50,000 in legal, accounting, travel and other business expenses. Cresta filed income tax returns as a personal holding company.

Abegg was not engaged in trade or business within the United States. In 1957 he was in the country only from January 1 to March 27. He was here more than 90 days in 1958. At the time when the Commissioner sent a notice of deficiency to Cresta as Hevaloid's transferee, Abegg had net assets in the United States more than sufficient to pay the tax allegedly owing from Hevaloid.

Reasons for Granting the Writ

I.

The Court of Appeals held that a reorganization within the meaning of I.R.C. §368(a)(1)(D) did take place between Hevaloid and Cresta (C.A. Op. *infra*, P. 12a). This is an important decision on a question of federal law which has not been, but should be settled by this Court. The decision by the court below is in clear and obvious conflict with the long settled "continuity of business enterprise" doctrine enunciated by this Court in *Gregory* v. *Helvering*, 293 U.S. 465 (1935). Indeed, the decision below might well be entitled "Continuity of Business Enterprise—The Death of a Doctrine."

The significance of this decision lies in the holding that a corporation which emerges from an I.R.C. §368(a)(1)(D) reorganization need not be engaged in *any active*

business enterprise but that the mere passive holding of investment assets as in the case of Cresta Corporation satisfies the requirements of I.R.C. §368(a)(1)(D). In *Helvering* v. *Gregory*, 69 F. 2d 809, 811 (2d Cir. 1934), aff'd, 293 U.S. 465 (1935), the Circuit Court stated that the underlying premises of the reorganization provisions is "that the readjustment shall be undertaken for reasons germane to the conduct of the venture in hand . . ." This Court, in affirming the Circuit Court decision stated:

> "When subdivision (b) speaks of a transfer of assets by one corporation to another, it means a transfer made 'in pursuance of a plan of reorganization' . . . *of corporate business;* and not a transfer of assets by one corporation to another in pursuance of a plan having no relation to the business of either, as plainly is the case." (emphasis supplied) *Gregory* v. *Helvering*, 293 U.S. 465, 469 (1935).

There are a number of Tax Court cases in which the failure of the acquiring company to conduct any business prevented the transaction from qualifying as a reorganization. Typical of these cases, all of which rely on *Gregory* v. *Helvering* for authority although there is no doubt as to the existence of a bona fide business purpose, are *Standard Realization Company*, 10 T.C. 708 (1948), acq., 1948-2 Cum. Bull. 3, *George D. Graham*, 37 B.T.A. 623 (1938), acq., 1938-2 Cum. Bull. 13 and *Dean Palmer*, 11 P-H B.T.A.-TC Mem. Dec. ¶42432 (1942). Underlying these decisions is the principle that a corporation which is not intended to transact business but merely to hold and dispose of property cannot be the sole product of a corporate reorganization. The reorganizations in these cases failed not because they lacked a business purpose but rather because they did not provide for any contin-

uity of business enterprise since the surviving corporations did not engage in any active business.

The Tax Court below cited four cases to sustain its statement that "when the stockholders of a corporation liquidate it and transfer its assets to another corporation, which continues the business under the same ownership, the effect of the transaction is a reorganization" (T.C. Op. *infra*, P. 41a). The statement correctly summarizes the holdings in the cited cases but fails to recognize the distinction between a transfer of operating assets used in an active business pursuit and the liquidation and retransfer of assets which consist only of cash or the equivalent. The cited cases all involved operating companies and not inactive holding companies.

All of the cases discussed here as well as the long line of cases which depend on *Gregory* v. *Helvering* for authority justify the conclusion that whatever may be the precise meaning of the "continuity of business enterprise" test, its requirements are only satisfied when the new corporation actively engages in the active conduct of some business. We urge that the absence of business activity conducted by Hevaloid and Cresta distinguishes this case in an extremely vital respect. Holding companies whose activity is limited to occasional stock market dealings cannot be held to satisfy one of the principal requisites of a reorganization—active continuance of business activity.

The regulations at Section 1.368-1(b) express the purpose and intent of the reorganization provisions as,

> "to except from the general rule certain specifically described exchanges incident to such readjustments of corporate structures made in one of the particular ways specified in the Code, as are required by *business exigencies* and which effect only a readjustment of continuing interest in property under

> modified corporate forms. Requisite to a reorganization under the Code are *continuity of the business enterprise* under the modified corporate form, and . . ." (emphasis supplied)

The regulations at Section 1.368-2(g) makes further reference to the business requirement of a reorganization as follows:

> ". . . Moreover, the transaction or series of transactions embraced in a plan of reorganization must not only come within the specific language of Section 368(a), but the readjustments involved in the exchanges of distributions effected in the consummation thereof must be undertaken for *reasons germane to the continuance of the business of a corporation*, a party to the reorganization." (emphasis supplied)

The regulations, as quoted above, express the long standing purpose and intent of the reorganization provisions that there be a reformation or reshaping of existing corporate business for the purpose of continuing some business activity. In the present case, neither Hevaloid nor Cresta engaged in any business before or after the transaction in question. If, in view of these facts, the decision of the court below is allowed to stand, then the important "continuity of business enterprise" doctrine will have been sapped of all meaning and vitality. Such a long standing doctrine, first enunciated by this Court, should not be allowed to die without this Court's final review.

II.

The decision below is a clear misapplication of the "reincorporation doctrine". The Court of Appeals recog-

nized "that the vice of liquidation-reincorporation appears most clearly when a company engaged in active business purports to liquidate but the shareholders then put the operating assets back into a new corporation." (C.A. Op. *infra*, P. 15a). The Court then correctly states that "there seems to be no similar necessity for stockholders who have received only liquid assets on liquidation to transfer them to a new corporation." (C.A. Op. *infra*, P. 15a). Despite the clear application of this latter principle to the present case, the Court below nevertheless found that a liquidation-reorganization occurred as between Hevaloid and Cresta. The Court quotes from Bittker and Eustice:

> "The 'reincorporation' problem arises when taxpayers seek to combine the benefits of a complete liquidation . . . with the 'reorganization' advantages of continued operation of the business in corporation form." (C.A. Op. *infra*, P. 15a).

However, the Court omits the next sentence which reads:

> "Before reorganization treatment can supplant liquidation treatment, however, *the twin factors of continuity of business enterprise* and continuity of shareholder investment must be present." Bittker and Eustice, Federal Income Taxation of Corporations and Shareholders, 572 (2d ed. 1966). (emphasis supplied)

The continuity of business enterprise is precisely the factor that is missing in the present case. Here Hevaloid, after years of participation in the business of licensing patents and leasing machinery, terminated all activity in November of 1955. It remained inactive for 14 months until it was formally liquidated and all of its assets, con-

sisting only of cash and securities were distributed to Abegg, its sole shareholder. Cresta *never* engaged in the patent licensing and machinery leasing business formerly conducted by Hevaloid. It follows from these facts that the liquidation of Hevaloid in form was a complete liquidation in substance and the reincorporation doctrine cannot change a complete and formal liquidation of a corporation into a reorganization.

This decision presents a drastic change in the law governing the reincoporation doctrine. Henceforth an individual who has, in corporate form, operated a grocery store cannot sell all store assets, liquidate the grocery store corporation and use such liquid assets to capitalize a new corporation to engage the art and antique business —without the danger of the Commissioner asserting the reincorporation doctrine and the attendant disastrous tax consequences.

Such a decision, which has the potential of effecting many taxpayers in the future, must be reviewed by this Court.

CONCLUSION

For the reasons stated, a writ of certiorari should issue to the United States Court of Appeals for the Second Circuit to review the judgment and decision of that Court affirming the order of the Tax Court in favor of the Commissioner of Internal Revenue.

Respectfully submitted,

JOSEPH A. MCMANUS
Attorney for Petitioner

Dated: New York, New York
October 9, 1970

APPENDIX

Statutes Involved

Section 368. Definitions Relating to Corporate Reorganizations.

(a) Reorganization.

(1) In General.—For purposes of parts I and II and this part, the term "reorganization" means—

(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356.

Regulations:

Definitions Relating to Corporate Reorganizations

§ 1.368-1. Purpose and Scope of Exception of Reorganization Exchanges.

(a) *Reorganizations.* As used in the regulations under parts, I, II, and III (section 301 and following, subchapter C, chapter 1 of the Code, the terms "reorganiza-

tion" and "party to a reorganization" mean only a reorganization or a party to a reorganization as defined in subsections (a) and (b) of section 368. With respect to insolvency reorganizations, see part IV, subchapter C, chapter 1 of the Code.

(b) *Purpose.* Under the general rule, upon the exchange of property, gain or loss must be accounted for if the new property differs in a material particular, either in kind or in extent, from the old property. The purpose of the reorganization provisions of the Code is to except from the general rule certain specifically described exchanges incident to such readjustments of corporate structures made in one of the particular ways specified in the Code, as are required by business exigencies and which effect only a readjustment of continuing interest in property under modified corporate forms. Requisite to a reorganization under the Code are a continuity of the business enterprise under the modified corporate form, and (except as provided in section 368(a)(1)(D)) a continuity of interest therein on the part of those persons who directly or indirectly, were the owners of the enterprise prior to the reorganization. The Code recognizes as a reorganization the amalgamation (occurring in a specified way) of two corporate enterprises under a single corporate structure if there exists among the holders of the stock and securities of either of the old corporations the requisite continuity of interest in the new corporation, but there is not a reorganization if the holders of the stock and securities of the old corporation are merely the holders of short-term notes in the new corporation. In order to exclude transactions not intended to be included, the specifications of the reorganization provisions of the law are precise. Both the terms of the specifications and their underlying assumptions and purposes must be satisfied in order to

entitle the taxpayer to the benefit of the exception from the general rule. Accordingly, under the Code, a short-term purchase money note is not a security of a party to a reorganization, an ordinary dividend is to be treated as an ordinary dividend, and a sale is nevertheless to be treated as a sale even though the mechanics of a reorganization have been set up.

(g) The term "plan of reorganization" has reference to a consummated transaction specifically defined as a reorganization under section 368(a). The term is not to be construed as broadening the definition of "reorganization" as set forth in section 368(a), but is to be taken as limiting the nonrecognization of gain or loss to such exchanges or distributions as are directly a part of the transaction specifically described as a reorganization in section 368(a). Moreover, the transaction, or series of transactions, embraced in a plan of reorganization must not only come within the specific language of section 368(a), but the readjustments involved in the exchanges or distributions effected in the consummation thereof must be undertaken for reasons germane to the continuance of the business of a corporation a party to the reorganization. Section 368(a) contemplates genuine corporate reorganizations which are designed to effect a readjustment of continuing interests under modified corporate forms.

(h) As used in section 368, as well as in other provisions of the Internal Revenue Code, if the context so requires, the conjunction "or" denotes both the conjunctive and the disjunctive, and the singular includes the plural. For example, the provisions of the statute are complied with if "stock and securities" are received in exchange as well as if "stock or securities" are received. [Reg. § 1.368-2.]

Opinion of the United States Court of Appeals for the Second Circuit

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Nos. 622 and 623—September Term, 1969.

(Argued May 28, 1970 Decided July 14, 1970.)

Docket Nos. 34136 and 34146

WERNER ABEGG,

Appellee,

—*v.*—

COMMISSIONER OF INTERNAL REVENUE,

Appellant.

CRESTA CORPORATION, S.A., Transferee,

Appellant,

—*v.*—

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

Before:

WATERMAN, FRIENDLY and HAYS,
Circuit Judges.

The Tax Court, John Gregory Bruce, *Judge*, 50 T.C. 145, sustained the Commissioner's determination of a deficiency in the income of Hevaloid Corporation on the theory that Hevaloid's liquidation and the prompt re-

transfer of its assets to Cresta Corporation in 1957 constituted a reorganization under I.R.C. §368(a)(1)(D), and his assessment of that deficiency against Cresta as transferee. It refused to sustain the Commissioner's determination that Werner Abegg, a Swiss citizen and sole owner of Cresta, was taxable on gain realized in 1958 when he contributed appreciated assets to Cresta, a foreign corporation, without first complying with I.R.C. §367. Cresta appeals from the former determination; the Commissioner from the latter. Affirmed on both appeals.

EMILIO A. DOMINIANNI, Esq. (John E. McDermott, Michael Keating and Coudert Brothers, New York, New York, of Counsel), *for Werner Abegg and Cresta Corporation.*

PAUL M. GINSBURG, Attorney, Department of Justice, Washington, D. C. (Johnnie M. Walters, Assistant Attorney General, Lee A. Jackson and Thomas L. Stapleton, Attorneys, Department of Justice, Washington, D. C., of Counsel), *for Commissioner of Internal Revenue.*

FRIENDLY, *Circuit Judge:*

These two appeals from a decision of the Tax Court, 50 T.C. 145, one by the taxpayer and the other by the Commissioner, concern a series of transactions in which Werner Abegg, a Swiss citizen, liquidated one wholly-owned personal holding company and transferred all its assets, plus other securities in substantial amount, to another personal holding company. Although the appeals relate to different tax years and present independent

legal issues, there is a sufficient identity in the dramatis personae to make it convenient to state all the facts at the outset.

I. *The Facts*

Hevaloid Corporation was organized under the laws of Delaware in 1938. All its issued stock, 250 shares, was held by Abegg. It owned industrial patents and machinery which it leased to various American corporations. In 1955 the patents expired and it sold the machinery. In 1956 and 1957 it was a personal holding company; its assets consisted exclusively of cash, securities, receivables, and rights in a motion picture "Guest in the House." In 1957, Robert A. Cavin, a close associate and business adviser of Abegg for many years, was its president.

On March 28, 1957, Hevaloid adopted a plan of complete liquidation and dissolution. A certificate of dissolution was filed on April 18. During April and May it sold stock in four publicly owned corporations for $1,671,341, which it deposited in the New York Trust Company. These sales represented a gain of $932,701. Hevaloid reported them in its 1957 income tax return but claimed that the gain was not to be recognized under I.R.C. §337. On May 1 and 2 it drew checks to Abegg on its account at New York Trust Company aggregating $1,660,936. On May 7 it delivered to Laird & Co., a New York brokerage firm, for Abegg's account, certificates and stock powers for 7,470 shares of Brazos River Gas Company, 2,720 shares of Medallion Petroleum Limited, and 12,692 shares of Producing Properties, Inc. On May 23 it directed Laird & Co. to transfer from the account of Hevaloid to the account of Abegg 1,945 shares of Magma Copper

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Cresta Corporation, S.A., originally known as Suvretta Corporation, S.A., was incorporated in Panama in 1941 but remained inactive. On May 7, 1957, it issued 1,000 shares of stock to Abegg in return for cash and other assets, as follows: On May 7, 1957, Abegg issued to it a $1,500,000 check on his account at Bankers Trust Company, $250,000 of which was considered a demand loan and $1,250,000 as part payment for stock. On May 24, Laird & Co., on Abegg's instruction, transferred to Cresta in further payment the five securities that Hevaloid had ordered it to transfer to him earlier that month. The fair market value of each security exceeded its adjusted basis; the aggregate excess was $262,520. The same day Abegg transferred stock of Illinois Central R.R., Olin Mathiesen Chemical Corporation, additional common shares and a note of Brazos River Gas Company, preferred stock and bonds of Producing Properties, Inc., 1,000 shares of Perosa Corporation, which were regarded as valueless, and 3,000 shares of Meridan Corporation, a Rhode Island corporation in which he owned 50% of the stock and Cavin 10%. Meridan had a net worth of $2,510,673 as of December 31, 1957. Nearly sixty per cent of this represented a piano business in Michigan; it also had an interest in an operating company in Chicago and later acquired one in a company in Tacoma, Washington.

On June 8 Abegg transferred to Cresta the interest in "Guest in the House" and in the debt from Perosa Corporation which Hevaloid had assigned.

The directors of Cresta, including Abegg and Cavin, met on February 6, 1958, in New York and resolved to qualify to do business in that state, to accept cash and securities from Abegg as contributions to capital, and to borrow an additional $250,000 from him on open account. Abegg drew a check for $400,000 and on February 25, 1958, contributed stock as follows:

	Adjusted Basis	*Fair Market Value*
50,680 shares Brazos River Gas Co.	$ 55,850	$101,360
4,250 shares General American Oil Co.	91,653	110,578
12,650 shares Magma Copper Co.	1,300,971	449,075
	$1,448,474	$661,013

Cavin was Cresta's sole employee in its fiscal years ending February 28, 1958 and 1959 and February 29, 1960. He maintained watch over its holdings, especially those in Meridan, and investigated at least a dozen opportunities for investing Cresta's funds with a view to acquiring the stock or assets of a going business, although no acquisitions were made. In these years Cresta paid salaries to Cavin aggregating $46,750, and also some $50,000 in legal

accounting, travel and other business expenses.[1] Cresta filed income tax returns as a personal holding company.

Only a few further facts need be stated; Abegg was not engaged in trade or business within the United States. In 1957 he was in the country only from January 1 to March 27. He was here more than 90 days in 1958. At the time when the Commissioner sent a notice of deficiency to Cresta as Hevaloid's transferee, Abegg had net assets in the United States more than sufficient to pay the tax allegedly owing from Hevaloid.

II. *Cresta's Appeal*

Viewed alone the liquidation of Hevaloid meets the requirements of I.R.C. §337(a).[2] The Commissioner does

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[1] An issue that was litigated before theTax Court but is not before us is whether, as Cresta claimed, it was engaged in a trade or business with in the United States, so as to be entitled to these deductions under IRC §882 or, as the Commissioner contended, was not so engaged and was therefore subject to the 30% tax on gross income imposed by IRC §881(a). The Tax Court decided in favor of the Commissioner. Cresta did not seek review of that decision and relies on it for one of its arguments on the appeal it has taken.

[2] "If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims, then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period."

not dispute this, nor its corollary that if §337 is applied, the $923,701 gain realized by Hevaloid on the sales of securities and Abegg's gain on the liquidation would escape United States taxation altogether. Hevaloid would not be taxable because of §337(a). Abegg would not be taxable on the gain from the liquidation of Hevaloid because as a non-resident alien, not engaged in trade or business within the United States, who was present in the United States for fewer than 90 days in 1957 he was subject to United States taxation only on capital gains from sales or exchanges of personal property in the United States while he was present here,[3] and Hevaloid's liquidating distributions were carried out during his absence.

On February 19, 1962, the Commissioner mailed to Cresta as transferee a notice of deficiency reading as follows:

> The reported liquidation of Hevaloid Corporation, the transfer of assets to W. Abegg and the retransfer of such assets by him to Cresta Corporation, S.A. were in substance, component steps in a reorganization within the meaning of section 368(a) of the Internal Revenue Code of 1954. Accordingly, the benefits of section 337 of the Internal Revenue Code of 1954 are not applicable and the capital

[3] I.R.C. §871. The section was extensively amended by Pub. L. No. 89-809, Title I, §103(a)(1), 80 Stat. 1547 (1966), and now taxes non-resident aliens on capital gains not effectively connected with the conduct of a trade or business in this country only if the alien was present in this country for 183 days or more during the taxable year. See S. Rep. No. 1707, 89th Cong., 2d Sess., reprinted in 1966 under U.S. Code Cong. & Adm. News 4446, 4467-70.

gains realized on the sale of assets as shown in the 1957 return of Hevaloid Corporation, are includible in gross income.

Since, in substance, Hevaloid Corporation in the course of the reorganization transferred assets to Cresta Corporation, S.A., a foreign corporation and did not secure clearance under section 367 of the Internal Revenue Code of 1954 prior to the transfer, Hevaloid Corporation is denied the benefits of section 361(a) of the Internal Revenue Code of 1954. The gains realized on the transfer as computed in Exhibit A are recognized.[4]

The gains from Hevaloid's sales of securities amounted, as previously indicated, to $932,701; the gains from the transfers to Cresta of property which Abegg had received from Hevaloid were $262,519 with respect to securities stated above, plus $4,725 with respect to "Guest in the House." The Tax Court sustained the Commissioner.

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[4] Section 367, no paradigm of draftsmanship, provides:

SEC. 367. FOREIGN CORPORATIONS.

In determining the extent to which gain shall be recognized in the case of any of the exchanges described in section 332, 351, 354, 355, 356, or 361, a foreign corporation shall not be considered as a corporation unless, before such exchange, it has been established to the satisfaction of the Secretary or his delegate that such exchange is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes. For purposes of this section, any distribution described in section 355 (or so much of section 356 as relates to section 355) shall be treated as an exchange whether or not it is an exchange.

Cresta does not dispute that if the result of the 1957 transactions had been achieved by a straightforward reorganization under §368(a)(1)(D), the gains realized by Hevaloid on sales of securities would not come under the non-recognition shelter of §337 and the gains realized on transfers of appreciated securities would likewise be taxable since they would qualify for non-recognition only by virtue of §§351 and 354(a)(1), and that protection was lost by failure to obtain a ruling under §367. It nevertheless contested the determination of deficiency on three grounds. It claimed that the reorganization provisions are not applicable to corporations that are mere personal holding companies; that if that position were rejected, the judicially created "liquidation-reincorporation" doctrine on which the Commissioner relied should not be applied when what has come to be a personal holding company as a result of the cessation of an active business distributes liquid assets to its sole stockholder; and, in any event, that, since the transfer from Hevaloid to Cresta was routed through Abegg and he was financially able to pay any tax owed by Hevaloid, Cresta was not liable as a transferee. The Tax Court rejected all three contentions. Although Cresta's arguments are not without force, we agree with the Tax Court.

Cresta concedes, as it must, that no case directly holds the reorganiaztion provisions inapplicable to personal holding companies, and indeed the one case cited that considered the question is to the contrary. *Estate of Elise W. Hill*, 10 T.C. 1090 (1948). Cresta nevertheless points to language in the Regulations and in judicial decisions referring to the need for a "business purpose" for the re-

organization[5] or for a "continuation of the business enterprise."[6] Relying in part on the Tax Court's ruling that it was not engaged in a trade or business for purposes of I.R.C. §882, see fn. 1, Cresta contends that the activies of a mere holding company are not enough of a "business" to satisfy these requirements. However, the language Cresta cites was not remotely addressed to the issue here under consideration, and we see no warrant for ruling that a personal holding company may not take advantage of the reorganization provisions if their requirements are otherwise met. Certainly it would be hard to require a personal holding company of its shareholders to recognize gain when the company undergoes "a statutory merger or consolidation," "a recapitalization," or "a mere change in identity, form or place of organization" within I.R.C. §§368(A), (E) and (F), and there would be little virtue in permitting them to take a loss at will by such a transaction. Thus we think it plain that reorganizations of personal holding companies fall within "the plain intent of the statute," *Gregory* v. *Helvering, supra,* 293 U.S. at 470, and should be treated accordingly. Indeed, the examples in §1.381(c)(14)-1(c) of the Regulations explicitly assume that a personal holding company may result from a reorganization.

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[5] *Helvering* v. *Gregory*, 69 F.2d 809, 811 (2 Cir. 1934), *aff'd*, 293 U.S. 465 (1935): "the underlying presupposition is plain that the readjustment shall be undertaken for reasons germane to the conduct of the venture in hand, not as an ephemeral incident, egregious to its prosecution." The requirement also appears, less elegantly, in §1.368-2(g) of the Regulations.

[6] *Lewis* v. *C.I.R.*, 176 F.2d 646 (1 Cir. 1949). See also Regs. §1.368-1(b).

Cresta's second argument, relating to the judge-made "liquidation-reincorporation" doctrine,[1] is more appealing, but not appealing enough. The doctrine indeed has its elements of curiosity. Building on statutory provisions intended for the benefit of taxpayers, over which the Treasury have vigilantly stood guard, it forces their consequences on taxpayers who want nothing of them. See Hewitt and Cuddihy, The Liquidation Reincorporation Problem, a Running Tax Battle, 12-13 (1969). However, the tax avoidance purposes that can be served by "the liquidation of a corporation followed by a transfer of part or all of the assets to a newly-organized corporation owned by the same shareholders" are so numerous and serious, see Bittker & Eustice, Federal Income Taxation of Corporations and Shareholders, 569-70 (2d ed. 1966), that the doctrine had to be created. In any event it is too late to question its vitality at Cresta does not do so.

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[1] The House draft of the 1954 Code, H.R. 8300, 83d Cong., 2d Sess., §357 (1954), attempted to deal with the problem in a manner that would not have helped the Commissioner in this case, since the proposed statute would have applied only when the distributee transferred more than 50% of the assets received on liquidation other than money and stock and securities (except stock or securities of the distributing corporation). This was deleted by the Senate without explanation. The House Managers attributed the deletion to "certain technical problems," and explained their acquiescence on the grounds "that, at the present time, the possibility of tax avoidance in this area is not sufficiently serious to require a special statutory provision" and that any such possibility "can appropriately be disposed of by judicial decision or by regulation within the framework of the other provisions of the bill." H.R. Rep. No. 2543, 83d Cong., 2d Sess. 41 (1954), reprinted in 1954 U.S. Code Cong. & Adm. News 5280, 5301. We do not regard any of this to be significant.

It is true enough that the vice of liquidation-reincorporation appears most clearly when a company engaged in active business purports to liquidate but the shareholders then put the operating assets back into a new corporation. Although as a practical matter incorporation is a necessity for the business, the shareholders by a mere sleight hand of hand would have withdrawn earnings and profits on payment only of a capital gains tax and would have achieved a stepped-up basis for appreciated assets if the liquidation-reincorporation doctrine did not prevent. There seems to be no similar necessity for stockholders who have received only liquid assets on liquidation to transfer them to a new corporation. However, Abegg evidently decided it was to his advantage that the management of certain of his liquid assets in the United States which the Delaware corporation had come to own as a result of cessation of its active business, as well as other assets transferred by him, should not be conducted by him, but rather by a Panamanian corporation qualified in New York, which should seek out opportunities for acquiring active businesses. As has been said, "The 'reincorporation' problem arise when taxpayers seek to combine the benefits of a complete liquidation (i.e., capital gain or loss on the distribution, a new basis for the assets, and elimination of corporate earnings and profits), with the 'reorganization' advantages of continued operation of the business in corporate form." Bittker & Eustice, *supra*, at 572. That is precisely what happened here, see Hewit and Cuddihy, *supra*, at 95-103; it was Abegg's decision to put the cash and securities derived from the liquidation of Hevaloid back into Cresta, rather than retain them in his own accounts with attendant freedom from United States taxes.

Cresta's argument that Hevaloid had already liquidated when it ceased its active business and thus could not liquidate again is mostly a play upon words. Like many other terms, liquidation does not mean in tax language what it may in ordinary speech. The Regulations, §1.332-2(c), instruct that "A status of liquidation exists when the corporation ceases to be a going concern and its activities are merely for the purpose of winding up its affairs, paying its debts, and distributing any remaining balance to its stockholders." Hevaloid did not attain that status until the spring of 1957. We do not regard *Pridemark, Inc.* v. *C.I.R.*, 345 F.2d 35 (4 Cir. 1965) relied on by Cresta, as conflicting in any way with the result reached here. The Commissioner in that case apparently did not argue that a "D" reorganization had occurred, but only that no "complete" liquidation had occurred within the meaning of §337, or alternatively that the liquidation and subsequent incorporation there constituted an "F" reorganization. See 345 F.2d at 41. The court rejected the first contention on the ground that the liquidation of the old company was intended to be complete and final, and the starting up of the new company was a later idea, hit upon only after the owners had been unsuccessful in other lines of business. The second contention was rejected on the ground that the shifts in officers and shareholder interests, along with the operating scale of the new company, were simply too much to be called a "mere change" in identity, form, or place of organization." It is apparent that neither basis of the decision is applicable here.

Cresta's final point goes to the question of transferee liability. The Supreme Court held in *Commissioner* v. *Stern*, 357 U.S. 39, 42, 45 (1958), that the predecessor of

§6901(a)[3] of the present code "neither creates nor defines a substantive liability but provides merely a new procedure by which the Government may collect taxes," and that "the existence and extent of liability should be determined by state law," her presumably the law of New York. Cresta contends that Hevaloid's transferee was Abegg, who could have been assessed until March 15, 1962, and that it cannot be held as transferee of Abegg because at the time of that transfer Abegg had assets in the United States sufficient to pay the tax. For the latter branch of its argument it relies on §273 of New York's Debtor and Creditor Law, making insolvency of the debtor an essential element of a fraudulent conveyance in the absence of actual fraud, which is not asserted by the Commissioner here.

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[3] SEC. 6901. TRANSFERRED ASSETS.

(a) *Method of Collection.*—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, paid, and collected in the same manner and subject to the same provisions and limitations as in the case of the taxes with respect to which the liabilities were incurred:

(1) *Income, estate, and gift taxes.*—

(A) *Transferees.*—The liability, at law or in equity, of a transferee of property—

(i) of a taxpayer in the case of a tax imposed by subtitle A (relating to income taxes),

(ii) of a decedent in the case of a tax imposed by chapter 11 (relating to estates taxes), or

(iii) of a donor in the case of a tax imposed by chapter 12 (relating to gift taxes),

in respect of the tax imposed by subtitle A or B.

However, although we have found no New York case directly in point, opinions such as those in *Salner Realty Corp.* v. *Nancy Lee Millinery, Inc.*, 262 App. Div. 491, 30 N.Y.S. 2d 596 (1st Dept. 1941), and *Beol, Inc.* v. *Dorf*, 22 Misc. 2d 798, 193 N.Y.S. 2d 394 (Sup. Ct. 1959), *aff'd mem.*, 12 App. Div. 459, 209 N.Y.S. 2d 267 (1st Dept. 1960), *appeal dismissed*, 9 N.Y. 2d 963, 218 N.Y.S. 2d 43 (1961), illustrate the concern New York shows for creditors of one corporation who suddenly find that its assets have been shuttled, mediately or immediately, to another controlled by the same interests. We therefore do not believe that the New York courts would regard Abegg's monetary ownership of Hevaloid's assets as sufficiently significant to free Cresta from the transferee liability to which it would otherwise have been subject.

III. *The Commissioner's Appeal*

The Commissioner also determined a deficiency with respect to Abegg's contributions to Cresta of 50,680 appreciated shares of Brazos River Gas Co. and of 4,250 appreciated shares of General American Oil Co. on February 26, 1958. He started from the fact that Abegg was present in the United States for more than 90 days in 1958, and from I.R.C. §871(a)(2)(B) and (b) which subject a nonresident alien so present to tax on "sales and exchanges of capital assets effected at any time during such year" in excess of losses from such sales and exchanges. He acknowledged that if Cresta had been a United States corporation, the contribution on his view would be protected by §351, which provides for non-recognition of gain or loss "if property is transferred to a corporation by one or more persons solely in exchange for stock in such cor-

poration and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation." But here again, the Commissioner contended, §367 reared its ugly head in Abegg's path. For, as stated in fn. 4, §367 mandates that "in determining the extent to which gain shall be recognized in the case of any of the exchanges described" in various sections including §351, "a foreign corporation shall not be considered a corporation" unless before such exchange a ruling has been obtained that the exchange is not in pursuance of a plan having federal income tax avoidance as a principal purpose, and it is stipulated that this was not done here.

In answer to the argument that since Abegg received nothing in exchange and thus realized no gain within the meaning of §1001(b), the Commissioner contended that issuance of stock by a corporation to a 100% shareholder is a meaningless ritual. He cited cases, notably *CIR* v. *Morgan*, 288 F. 2d 676 (3 Cir.), *cert. denied*, 368 U.S. 836 (1961), and *Davant* v. *C.I.R.*, 366 F. 2d 874, 884-87 (5 Cir. 1966), *cert. denied*, 386 U.S. 1022 (1967), which applied the liquidation-reincorporation doctrine to find a "D" reorganization although the transfer was from one owned corporation to another and there was no "distribution" of stock of the latter. He also relied on the holding in *King* v. *United States*, 10 F. Supp. 206 (D. Md.), *aff'd*, 79 F. 2d 453 (4 Cir. 1935), that a corporation which received property from its sole shareholder without consideration took the latter's basis under §204(a)(8) of the Revenue Act of 1926, relating to property acquired by a corporation "by the issuance of stock or securities" in a transaction where

the seller's gain or loss was not recognized.[9] In answer to the point that the aggregate effect of the three security transfers on February 26, 1958, was a loss of $787,461, the Commissioner responded, in line with Rev. Rul. 67-192, 1967-2 Cum. Bull. 140, that §367 cancels only the nonrecognition of gain provided by §351 but leaves intact that section's provision for nonrecognition of loss.

Not reaching the last point, the Tax Court found determinative the absence of any stock issuance in exchange. It refused to follow Rev. Rul. 64-155, 1964-1 Cum. Bull. (Part 1) 138, in which the Commissioner took the same position he urges here, and it distinguished *King* v. *United States*, *supra*, 10 F. Supp. 206, and *C.I.R.* v. *Morgan*, *supra*, 288 F. 2d 676, on which that ruling had relied. The Commissioner vigorously challenges this holding. He cites the report of the Senate Finance Committee which explained the importance of §112(k) of the Revenue Act of 1932, the progenitor of §367, in preventing tax avoidance by a procedure whereby a taxpayer with large unrealized profits in securities would transfer them to a foreign corporation in exchange for its stock without rec-

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[9] Abegg seeks to distinguish *King* on the basis that the shares in question were contributed within 30 days on the issuance of stock for other shares owned by the organizer and the delay apparently was accidental. Congress solved the problem that gave rise to the *King* case and also to *Rosenbloom Finance Corp.*, 24 B.T.A. 763 (1931), *rev'd* 66 F.2d 556 (3 Cir.), *cert. denied*, 290 U.S. 692 (1933), by enacting §113(8) of the Revenue Act of 1932, now I.R.C. §362, which provided that a corporation takes the transferor's basis for property acquired "by the issuance of its stock or securities in connection with a transaction described in section 112(b)(5)" *or* "as paid-in surplus or as a contribution to capital."

ognition of gain under the predecessor of §351, would have the foreign corporation sell the securities in a foreign country imposing no tax on the gain, would cause the foreign corporation to invest the proceeds in the stock of a new American subsidiary, and would then have the foreign corporation distribute the latter's stock in a tax-free reorganization. S. Rep. No. 665, 72d Cong., 1st Sess., pp. 26-27, 1939-1 Cum. Bull. (Part 2) 496, 515.[10] The Commissioner argues that the tax avoidance potential would be equally great where a sole shareholder contributed appreciated securities to an existing foreign corporation, possibly with only a nominal capitalization.

That is very likely so, but the 1932 Congress took steps to deal expressly with that problem so far as United States citizens were concerned. By §901 of the Revenue Act of 1932, now carried forward as I.R.C. §1491, it imposed on "the transfer of stock or securities by a citizen or resident of the United States, or by a domestic corporation or partnership, or by a trust which is not a foreign trust, to a foreign corporation as paid-in surplus or as a contribution to capital, or to a foreign trust, or to a foreign partnership, an excise tax equal to 25 per centum of the excess of (1) the value of the stock or securities so transferred over (2) its adjusted basis in the hands of the transferor . . ."; §902(b) made this tax inapplicable "if prior to the transfer it has been established to the satisfaction of the Commissioner that such transfer is not in pursuance of a plan having as one of its principal pur-

[10] For another example, wherein the appreciated securities are owned by a United States corporation, see Section 367 and Tax Avoidance: An Analysis of the Section 367 Guidelines, 25 Tax L. Rev. 429, 432 (1970).

poses the avoidance of Federal income taxes."[11] See Sen. Rep. No. 665, 72d Cong., 1st Sess., pp. 55-56, 1939-1 Cum. Bull. (Part 2) 496, 536. If the combination of §112(k) and 112(b)(5), the predecessor of I.R.C. §351, reached a contribution to the capital or paid-in surplus of a foreign corporation, §901 was unnecessary, since Congress obviously did not mean that in the absence of an advance ruling by the Commissioner such a contribution by a United States citizen should be subjected both to income taxation on any excess of value over basis and to excise taxation on the same amount, whereas an exchange in the literal sense should be subjected only to the former. Hence, unless §901 is to be a dead-letter, §112(k) must be read as not reaching a contribution to the capital of a foreign corporation by a United States citizen taxpayer covered by §901.[12] But it would be anomalous to hold that although the combination of §112(k) and §112(b)(5) of the 1932 Act, now I.R.C. §351, did not reach the important subject of contributions of appreciated assets to capital or paid-in surplus by a United States citizen to a foreign corporation, which Congress felt obliged to cover separately in §901, it did reach contributions of such assets as capital or paid-in surplus by nonresident aliens. While the alternative, distinguishing among transfers by nonresident aliens to wholly-owned foreign corporations on

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[11] These two sections of the 1932 Act became I.R.C. §§1491 and 1492(2) except that the rate was increased to 27½%.

[12] The Commissioner conceded at argument that if we should sustain his position a to the coverage of §367, it would be necessary to issue a ruling, which he undertook to do, that the same transaction was not to be subjected both to income and to excise tax.

the basis of whether they take stock back, is also anomalous, it is less so. Indeed, the real anomaly may be in a nonresident alien's being caught in the net at all, when he could have avoided the problem altogether by selling there are significant avenues of tax avoidance in respect the securities abroad and transferring the proceeds. If of the contribution by nonresident aliens of appreciated assets to capital or surplus of foreign corporations in the United States, the Commissioner has not brought them to our attention.

To put the matter in another way, since the legislative history shows that §367 was aimed primarily at tax avoidance by United States taxpayers, nonresident aliens should not be subjected to it in a situation where, as regards United States citizens, Congress thought it necessary to make a special although similar provisions. Counsel for a nonresident alien reading §901 of the 1932 Act or §1491 of the 1954 Code would be abundantly justified in thinking that Congress meant to require advance approval of contributions to the capital or paid-in surplus of a foreign corporation only when these were made by the persons there described. It may well be, as the Commissioner suggests, that §901, like the change in §113(8) of the 1932 Act, see fn. 9, represented an unnecessary overreaction to the decision of the Board of Tax Appeals with respect to contributions to capital or surplus in the *Rosenbloom* case, and that if Congress had only remained silent, the courts would have handled the problem. But Congress did what it did, and a taxpayer is justified in assuming that it cast its net no further. Agreeing with the Commissioner that the problem is considerably more difficult than the Tax Court thought, we thus believe it reached the right result.

On both appeals the judgment of the Tax Court is affirmed. No costs.

Opinion of the Tax Court of the United States

50 T. C. No. 17

TAX COURT OF THE UNITED STATES

WERNER ABEGG, et al.,[1] Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent.

Docket Nos. 1570-62,
1571-62;
1572-62.

Filed April 25, 1968.

Abegg, a nonresident alien in 1957, liquidated Hevaloid, a wholly-owned Delaware corporation, which was a personal holding company, and exchanged the property and cash he then received for all the stock of Suvretta, a Panama corporation, also a personal holding company. The name Suvretta was changed to Cresta on or about March 5, 1958. In February 1958 he contributed additional securities to the capital of Suvretta having fair market values some in excess of his basis and some below his basis. No ruling under section 367 was requested. In 1958, 1959, and 1960 Cresta unsuccessfully sought opportunities for investments in active businesses in the United States.

Held: (1) Cresta was not engaged in trade or business in the United States during the taxable years ended in 1958, 1959 and 1960.

(2) The liquidation of Hevaloid and transfer of its assets to Suvretta amounted to a reorganization under section 368(a)(1)(D), I.R.C. 1954;

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[1] Proceedings of the following petitioners are consolidated herewith: Cresta Corporation, S.A., Transferee, Docket No. 1571-62; Cresta Corporation, S.A., Docket No. 1572-62.

(3) Since no ruling under section 367 was sought, the gains realized by Hevaloid on liquidation and the transfer are recognized;

(4) Cresta is liable as a transferee of assets for deficiencies determined against Hevaloid; and

(5) The transfer of assets to Suvretta in 1958 by its sole stockholder was a contribution to capital and not an exchange resulting in taxable gain to the transferor

EMILIO A. DOMINIANNI and JOHN E. MCDERMOTT, for the petitioners.

EUGENE S. LINETT, for the respondent.

BRUCE, *Judge*: These consolidated cases involve deficiencies determined in income taxes and additions to tax as follows:

Docket No.	*Petitioner*	*Year*	*Deficiency*	*Addition to Tax § 6651(a) IRC 1954*
1570–62	Werner Abegg	1958	$ 20,213.96	—
		1959	146.00	—
		1960	27.15	—
1571–62	Cresta Corporation, S.A., Transferee	1957	296,952.18	—
		F/Y Ended		
1572–62	Cresta Corporation, S.A.	2/28/58	19,258.45	—
		2/28/59	35,292.99	$3,518.86
		2/29/60	43,264.30	—

Werner Abegg does not contest the deficiencies for 1959 or 1960 in Docket No. 1570-62. Respondent concedes the addition to tax for 1959 for delinquent filing determined against Cresta Corporation, S.A., in Docket No. 1572-62. Other concessions were made by both parties which will be given effect under Rule 50.

The issues for decision are (1) whether Cresta Corporation, S.A., was engaged in trade or business in the United States in its fiscal years ended in 1958, 1959, and 1960; (2) whether the liquidation of Hevaloid and the activation of Suvretta amounted to a reorganization within the meaning of section 368(a)(1) of the 1954 Code; (3) whether the gains upon liquidation and transfer of assets are to be recognized; (4) whether Cresta is liable as a transferee for a deficiency determined against Hevaloid Corporation for 1957; and (5) whether a transfer of assets by Werner Abegg to Suvretta in 1958 resulted in taxable gain or recognizable loss to Abegg.

Findings of Fact.

The stipulation of facts and the exhibits attached thereto are incorporated herein by this reference.

Werner Abegg has been a citizen of Switzerland since prior to 1938. Except for 1940 through 1946, he has not been a resident of the United States. He is an industrialist. From 1946 until 1966 he was not engaged in business in the United States. In 1957 he was in the United States from January 1 to March 27 only. Throughout the year 1957 his United States assets exceeded his liabilities by at least $2 million. He filed a Federal income tax return for 1958 with the district director of internal revenue for Upper Manhattan, New York. The return, on Form 1040NB, reported income of $12,912.55 from dividends and tax liability of $3,873.78, withheld at source.

Survetta Corporation, S.A., was incorporated in 1941 under the laws of the Republic of Panama. Its name was changed to Cresta Corporation, S.A., on or about March 5, 1958. Its authorized capital stock was 1,000 shares of no par value common stock. In the years in issue Werner Abegg was its sole stockholder. It filed Federal corporation income tax returns for fiscal years ending the last day of February in 1958, 1959, and 1960 with the district di-

rector of internal revenue for Upper Manhattan, New York. It was organized to acquire certain patents registered under the laws of various foreign nations, but as a consequence of the German occupation of Luxembourg this purpose was not carried out and it was inactive until 1957.

Hevaloid Corporation was organized under the laws of the State of Delaware in 1938. Its authorized capital was 2,000 shares of no par value common stock of which 250 shares were issued to Werner Abegg. No other stock was issued. It filed corporation income tax returns for the calendar years 1956 and 1957 with the district director of internal revenue for Upper Manhattan, New York.

Robert A. Cavin has been a close associate, friend, and business adviser to Werner Abegg since prior to 1938. During the year 1957 Robert A. Cavin was president of Hevaloid. During the years 1958, 1959, and 1960 Robert A. Cavin was president and treasurer of Cresta.

On June 27, 1938, Hevaloid purchased from Cela Holding, S.A., a corporation organized under the laws of Luxembourg, 12 patents and patent applications registered under the laws of the United States and 10 patents and patent applications registered under the laws of Canada. These patents related to the manufacture of belts and belting and various rubber products from various chemical processes. Hevaloid also purchased presses and other machinery to be used in the manufacture of such belts and belting and rubber products.

From 1938 until November 1944 Hevaloid leased its patents and machinery to L. H. Gilmer Company of Philadelphia, Pennsylvania. From 1944 until April 1947 Hevaloid leased its patents and machinery to the U. S. Rubber Company.

In April of 1945 Hevaloid acquired from Cela Holding, S.A., certain other patents registered under the laws of various foreign nations.

From April 1947 until November 1955 Hevaloid leased its patents and machinery to Globe Woven Belting Co. of Buffalo, New York. In 1955 all of Hevaloid's patents expired and it sold all of its machinery to Globe Woven Belting Co. in November of that year. In 1956 and 1957 Hevaloid's assets consisted exclusively of cash, stocks and securities, receivables and certain rights in the motion picture, "Guest In The House."

During the period March 28, 1957, to December 11, 1957, Hevaloid was completely liquidated and dissolved in the following manner:

(a) A special meeting of the Board of Directors of Hevaloid was held on March 28, 1957, and a plan of complete liquidation and dissolution was duly adopted.

(b) On April 3, 1957, a consent to the dissolution of Hevaloid was duly executed by Werner Abegg and was filed with the State of Delaware.

(c) A certificate of dissolution was issued by the State of Delaware on April 18, 1957, and was recorded, and immediately thereafter Hevaloid withdrew from the various states in which it was authorized to do business.

(d) During April and May of 1957 Hevaloid, pursuant to its plan of liquidation, sold the following stocks. The sales of these stocks were effected by Laird & Co., stock brokers:

Name of Stock	*No. of Shares*	*Cost*	*Date Sold*	*Amount Realized on Sale*	*Gain*
General American Oil Co. of Texas	7,926 88/100	$122,254.42	4/26/57 5/ 1/57	$ 317,981.88	$195,727.46
Signal Oil and Gas Co.	21,155	489,794.11	4/30/57 5/ 2/57	1,174,899.08	685,104.97
Great Northern Ore Properties	37,000	75,014.71	4/25/57 5/ 1/57	114,281.17	39,266.46
Sinclair Oil Corporation	1,000	51,576.20	4/25/57	64,178.58	12,602.38
Totals		$738,639.44		$1,671,340.71	$932,701.27

These sales were included in Schedule D of Hevaloid's final Federal income tax return for the taxable year 1957 but were claimed as not recognized pursuant to the provisions of section 337 of the 1954 Code. The proceeds from the sales of such stocks were deposited to Hevaloid's account in the New York Trust Company, New York City, New York.

(e) On May 7, 1957, Hevaloid executed stock powers and distributed, pursuant to its plan of complete liquidation, the following stocks to Werner Abegg by delivery of the certificate and stock powers to Laird & Co. in New York, New York:

Name of Corporation	*Adjusted Basis*	*Fair Market Value*
7,470 shares Brazos River Gas Company	$ 9,337.50	$ 22,410.00
2,720 shares Medallion Petroleum Limited	4,767.54	13,545.60
13,692 shares Producing Properties, Inc.	45,340.00	95,844.00
	$59,445.04	$131,799.60

(f) On May 23, 1957, pursuant to instructions received from Hevaloid issued under its plan of complete liquidation, Laird & Co., New York, New York, transferred the following stocks from the account of Hevaloid to the account of Werner Abegg:

Name of Corporation	*Adjusted Basis*	*Fair Market Value*
1,945 shares Magma Copper Company	$ 53,097.30	$145,996.95*
2,600 shares Signal Oil and and Gas Company	60,196.95	157,462.50
	$113,294.25	$303,459.45

*As shown by paragraph 11(f) of stipulation. Paragraph 15(b) of stipulation uses figure $145,996.56.

(g) On May 23, 1957, Hevaloid executed assignments in favor of Werner Abegg, transferring to him, pursuant to its plan of complete liquidation, its interest in the loan receivable due from Perosa Corporation and in the motion picture film right "Guest in The House." Hevaloid had a zero basis for "Guest in The House."

(h) During the period March 28, 1957, to December 11, 1957, Hevaloid made the following distributions in cash, pursuant to its plan of complete liquidation, to its sole stockholder, Werner Abegg, and closed its bank accounts with the New York Trust Company and Hunterdon County National Bank, Hunterdon County, New Jersey. On May 1, 1957, Hevaloid drew its check payable to Werner Abegg on the New York Trust Company in the amount of $1,500,000. On May 2, 1957, Hevaloid drew its check on the New York Trust Company payable to Werner Abegg in the amount of $160,936.20. On December 11, 1957, Hevaloid drew its check on the Hunterdon County National Bank payable to Werner Abegg in the amount of $32,156.05. All three checks were deposited to the account of Werner Abegg at the Bankers Trust Company, New York City, New York. All of Hevaloid's assets were distributed in complete liquidation by December 11, 1957.

Meridan Corporation, hereinafter called Meridan, was a corporation organized under the laws of Rhode Island in 1940. In 1951 all of its stock was owned by the following:

Name	*Number of Shares*
G. Fry	200
G. B. Fry	600
T. Harwood	800
S. Schiff	800
Werner Abegg	2,500
	4,900

In 1954 Werner Abegg purchased an additional 1,100 shares of the stock of Meridan, of which he transferred 600 shares to Robert A. Cavin, leaving Werner Abegg with 3,000 shares and Meridan with 6,000 shares issued and outstanding.

In 1954 Meridan acquired the plant, business, and other assets of Everett Piano Company of South Haven, Michigan.

The financial statement of Meridan as of December 31, 1957, which it is agreed fairly reflects the position of Meridan as of May 1, 1957, shows:

	Everett Piano Division	*Total*
Assets	$1,845,991.89	$3,276,125.94
Liabilities	436,359.67	765,453.07
Stockholders' equity ..	1,409,632.22	2,510,672.87

On May 6, 1957, Suvretta issued 1,000 shares of its no par common stock to Werner Abegg in return for cash and other assets as follows:

(a) On May 7, 1957, Werner Abegg's check drawn on the Bankers Trust Company payable to Suvretta in the amount of $1,500,000 was received by Suvretta and deposited to its account at the First National City Bank, New York. Of this amount, $1,250,000 was paid in for stock and $250,000 was a demand loan.

(b) An May 24, 1957, Laird & Co. under instructions of Werner Abegg transferred from the account of Werner Abegg to the account of Suvretta the following stocks:

	Name of Corporation	*Fair Market Value*
2,600	shares of Signal Oil and Gas Company	$157,462.50
1,945	shares of Magma Copper Company	145,996.56

12,054) 7,470)	shares of Brazos River Gas Company	58,572.00
2,720	shares of Medallion Petroleum Limited	13,545.60
13,692	shares of Producing Properties, Inc.	95,844.00
2,000	shares of Illinois Central Railroad	111,500.00
$160,000	5½% note, due 1976—Brazos River Gas Company ..	118,400.00
620	shares of Producing Properties, Inc. 6% preferred ...	9,842.50
$46,500	5% bond due 1969—Producing Properties, Inc.	27,376.88
1,000	shares of Olin Mathieson Chemical Corporation ...	53,562.50
		$792,102.54

All of the above stocks were marketable and could be sold on various stock exchanges in the United States and on the over-the-counter market.

(c) On May 24, 1957, Werner Abegg executed stock assignments in favor of Suvretta, transferring to Suvretta 3,000 shares of Meridan Corporation stock, having a fair market value of $1,291,080 and 1,000 shares of Perosa Corporation stock which had no value.

(d) On June 8, 1957, Werner Abegg executed assignments in favor of Suvretta, transferring to Suvretta his interest in the motion picture film right "Guest In The House" and his interest in a debt due from Perosa Corporation. Approximately $18,000 was collected on this debt, and in a subsequent year the balance was written off as uncollectible. The sum of $2,550, all of which was collected prior to 1961 with respect to the motion picture film right "Guest In The House," has been collected to

the date of trial. The film right has never been sold by Suvretta or Cresta.

On February 6, 1958, the directors of Suvretta held a meeting in New York, New York. The members of the board, Werner Abegg, Robert A. Cavin, James E. Hughes, and George F. Mason, Jr., were all present. It was resolved that the corporation take all action necessary to qualify it to do business in the State of New York, that it accept certain transfers of cash and securities from Abegg as contributions to capital, and that it borrow an additional $250,000 from Abegg on open account repayable on demand.

On February 13, 1958, Werner Abegg's check drawn on Bankers Trust Company payable to Suvretta in the amount of $400,000 was received by Suvretta and deposited to its account at the First National City Bank, New York, New York. This amount was recorded as a contribution to capital.

On February 26, 1958, Abegg transferred to Suvretta the following shares of stock, and such transfer was recorded on the books of Suvretta as a contribution to capital. Suvretta did not issue its stock or any other property to Abegg in exchange therefor. All of the contributed stock was held by Abegg since prior to December 31, 1957, and as to Abegg were capital assets:

Stock	*Adjusted Basis*	*Fair Market Value*
50,680 shares of Brazos River Gas Company	$ 55,850.00	$101,360
4,250 shares of General American Oil Company	91,653.12	110,578
12,650 shares of Magma Copper Company	1,300,970.50	449,075
	$1,448,473.62*	$661,013

* Paragraph 20 of stipulation incorrectly stated total adjusted basis as $1,348,473.62.

Abegg effected the transfer of such stocks to Suvretta while present in the United States and the transfer was made in the United States. Abegg was present in the United States from January 17, 1958, through May 17, 1958.

On May 29, 1957, Abegg drew a check on Bankers Trust Company payable to Suvretta in the amount of $400,000 which was received by Suvretta and deposited to its account at the First National City Bank, New York, New York. This amount was recorded as a contribution to capital.

On or about February 6, 1958, Suvretta attempted to register with New York State as a corporation which would do business in New York State and discovered that the similarity of its name to another corporate name would require it to change its name. Accordingly, Suvretta changed its name to Cresta on or about March 5, 1958, and on or about the same date registered with New York State as a corporation doing business in New York State.

Subsequent to the mailing of the notice of liability in case docket number 1571-62, Cresta paid $296,952.18 with respect to the deficiency determined against Hevaloid for the taxable year ended December 31, 1957.

Subsequent to the mailing of the notice of deficiency in case docket number 1572-62, Cresta made the following payments of tax with respect to the following taxable years (which payments were assessed on March 16, 1962, under section 6213(b)(3), 1954 Code):

F/Y Ended	*Amount*
2/28/58	$19,258.45
2/28/59	35,292.99
2/29/60	43,264.30

No determination or ruling under section 367, 1954 Code, was ever requested as to any of the transactions described herein by Abegg, Suvretta or Cresta, Hevaloid, or any other person.

Meridan owned interests in United Products Company, a machine shop in Tacoma, Washington, and Flexonics Corporation, a Chicago corporation. United Products Company had some 50 to 70 employees at Tacoma. Everett Piano Company had over 300 employees at South Haven, Michigan. Cavin was president of Meridan in the years 1959 and 1960.

In Cresta's fiscal years ended in 1958, 1959, and 1960 Cavin investigated at least 11 business opportunities for the investment of Cresta's funds with a view to acquiring the stock or the assets of one or more going businesses. No such acquisition was made in those years. Cavin was the sole employee of Cresta in those years.

Hevaloid was a personal holding company in 1956 and 1957. Cresta was a personal holding company in its fiscal years ended in 1958, 1959, and 1960. Cresta was not engaged in trade or business in the United States in those years.

Opinion

Werner Abegg, a nonresident alien, was sole stockholder of a Delaware corporation, Hevaloid, which had for a number of years been engaged in business in the United States as owner and lessor of certain patents and machinery. In 1955 its patents expired and it sold the machinery. Thereafter, until liquidated in 1957, its sole assets were cash, securities, receivables and certain rights in a motion picture. It was then a personal holding company and so characterized itself in its returns for 1956 and 1957. In 1957 Abegg liquidated Hevaloid and had the assets transferred to himself. In the same year he transferred to a Panamanian corporation, Survetta (now called Cresta) all the securities and other properties he received from Heva-

loid and certain additional securities and cash, and he received all the stock of this corporation. He also transferred to it 3,000 shares of stock (of 6,000 shares outstanding) of Meridan Corporation, a Rhode Island corporation which controlled certain other active corporations in the United States. Survetta was a personal holding company in 1957 and during the years in issue and so designated itself on its returns for the fiscal years ended in 1958 and 1959. In 1958 it was registered as a corporation doing business in New York State.

In docket No. 1572-62 respondent determined that Cresta was not engaged in trade or business in the United States in the fiscal years ended in 1958, 1959, and 1960. If not so engaged it is a foreign corporation taxable under section 881(a) of the Internal Revenue Code of 1954,[2] without allowance of deductions. If engaged in trade or business in the United States it is taxable under section 882 and certain deductions are allowable.

In these fiscal years Cresta paid Cavin salary totaling $46,949.78 and paid $52,017.87 in legal, accounting, travel, and other business expenses. Of this total, $83,815.32 was deducted as expenses allocable to United States sources.

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[2] All Code references herein are to the Internal Revenue Code of 1954, effective during the taxable years involved, unless otherwise indicated.

SEC. 881. TAX ON FOREIGN CORPORATIONS NOT ENGAGED IN BUSINESS IN UNITED STATES.

(a) Imposition of Tax.—In the case of every foreign corporation not engaged in trade or business within the United States, there is hereby imposed for each taxable year, in lieu of the taxes imposed by section 11, a tax of 30 percent of the amount received from sources within the United States as interest (except interest on deposits with persons carrying on the banking business), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains profits, and income * * *

Cresta's activities were collecting dividends and interest, managing existing investments, and investigating the acquisition of new investments. Respondent contends that these do not constitute a trade or business.

Abegg transferred to Suvretta (later named Cresta) some $5 million in cash, marketable securities, and other property. As president of Cresta, Cavin made efforts to acquire business ventures in the United States. He investigated at least 11 concerns with a view to having Cresta acquire a substantial stock interest or control. He also managed the activities of Meridan, of which he was also president. Meridan owned interests in Everett Piano Company, at South Haven, Michigan, United Products Company, a machine shop in Tacoma, Washington, and Flexonics Corporation, a Chicago corporation. Cresta had no employees other than Cavin. Meridan had some 350 or more employees in its branches or subsidiaries. Fifty percent of Meridan's stock was owned by Cresta and ten percent by Cavin. Cresta contends that through these activities it was engaged in trade or business in the United States.

We have repeatedly held that searching for business opportunities with a view to undertaking them does not constitute engaging in business and that expenses incurred in connection with such investigations are not deductible as ordinary or necessary expenses of a trade or business. *George C. Westervelt,* 8 T. C. 1248 (1947); *Dwight A. Ward,* 20 T. C. 332 (1953), aff'd 224 F. 2d 547 (C. A. 9, 1955); *Morton Frank,* 20 T. C. 511 (1953); *Frank B. Polachek,* 22 T. C. 858 (1954); and *Radio Station WBIR, Inc.,* 31 T. C. 803 (1959). See also, *Richmond Television Corporation* v. *United States,* 345 F. 2d 901 (C. A. 4, 1965). Nor does Cresta's management of its investment in Meridan constitute engaging in business on its own account. *Whipple* v. *Commissioner,* 373 U. S. 193 (1963). Although Cresta had an office in New York with one employee, Cavin,

and had qualified to do business in the state of New York, and although Abegg, its sole stockholder, provided advice on his sporadic visits to the United States, and occasional meetings of its board of directors were held in the United States, these were nothing more than planning activities and do not constitute engaging in a trade or business. Cresta's activities as a personal holding company were confined to holding securities and cash and the purchase and sale of investment securities. These activities do not amount to engaging in business. See *Chang Hsiao Liang*, 23 T. C. 1040 (1955).

We conclude that Cresta was not engaged in a trade or business in the United States in any of the fiscal years ended in 1958, 1959 and 1960. It is therefore taxable under section 881 as respondent determined, and not under section 882, of the 1954 Code.

In docket No. 1571-62, respondent determined a deficiency in the income tax liability of Hevaloid Corporation for the taxable year ended December 31, 1957, and notified Cresta that the deficiency, plus interest, would be assessed against Cresta as a transferee of assets of Hevaloid. The notice states:

> The reported liquidation of Hevaloid Corporation, the transfer of assets to W. Abegg and the retransfer of such assets by him to Cresta Corporation, S.A. were in substance, component steps in a reorganization within the meaning of section 368(a) of the Internal Revenue Code of 1954. Accordingly, the benefits of section 337 of the Internal Revenue Code of 1954 are not applicable and the capital gains realized on the sale of assets as shown in the 1957 return of Hevaloid Corporation, are includible in gross income.
>
> Since, in substance, Hevaloid Corporation in the course of the reorganization transferred assets to Cresta Corporation, S.A., a foreign corporation and

did not secure clearance under section 367 of the Internal Revenue Code of 1954 prior to the transfer, Hevaloid Corporation is denied the benefits of section 361(a) the Internal Revenue Code of 1954. The gains realized on the transfer as computed in Exhibit A are recognized.

The gains referred to in the first paragraph were long-term capital gains in the amount of $932,701.27. The gains referred to in the second paragraph were computed on five stocks and the film described in the findings of fact, and amounted to $267,244.46.

Cresta contends that Hevaloid was completely liquidated and was not reorganized; that it had been in active business as lessor of patents and machinery; and that such business had come to an end and the corporation was formally liquidated. Petitioner argues that the "reincorporation" doctrine has no proper application here. Petitioner says that Suvretta did not continue the business of Hevaloid, that its business was new and different, involving the management of a subsidiary, Meridan, which had no connection with Hevaloid, and the search for new businesses for acquisition or investment.

Prior to its liquidation Hevaloid had ceased its active business and was a personal holding company. After the transfers Suvretta was a personal holding company and was not actively engaged in a trade or business. Its function was the same as that of Hevaloid before the transfers.

The petitioner also contends that respondent has not proved a transfer of Hevaloid's assets to Suvretta.

Respondent admits that Hevaloid never transferred property directly to Suvretta, but contends that all the assets owned by Hevaloid immediately prior to its liquidation were transferred to Suvretta indirectly through Abegg as a conduit. In May 1957 Hevaloid distributed to Abegg shares

of stock of Brazos River Gas Company, Medallion Petroleum Limited, Producing Properties, Inc., Magnum Copper Company, and Signal Oil & Gas Company, also, a loan receivable from Perosa Corporation and a film right, and in the same month Abegg transferred identical stocks and properties to Suvretta. Also, Hevaloid distributed to Abegg $1,500,000 and $103,936.20 in cash in May 1957 and Abegg transferred $1,500,000 and $400,000 in cash to Suvretta in the same month. At the beginning of these transactions Abegg was the sole shareholder of Hevaloid, a personal holding company, and at the completion of the transactions he was sole shareholder of Suvretta, also a personal holding company. All the cash and income-producing assets of Hevaloid were acquired by Suvretta. Hence, respondent says that Suvretta became substantially a continuation of Hevaloid, and the effect of the transactions was a reorganization under section 368(a)(1)(D).[3]

In 1957 when Abegg proceeded to liquidate Hevaloid, he

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[3] SEC. 368. DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS.

(a) Reorganization.—

(1) In General.—For purposes of parts I and II and this part, the term "reorganization" means—

* * * * * * *

(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under sections 354, 355, or 356;

* * * * * * *

(F) a mere change in identity, form, or place of organization, however effected.

took the formal steps required to comply with section 337(a)[1] and avoid recognition of gain upon the sale or exchange of its property. In this liquidation the corporation realized gains in the amount of $932,701.27. However, Abegg at the same time transferred all the properties and cash he received from Hevaloid to Suvretta in exchange for its stock. Suvretta was in effect a continuation of the business of Hevaloid in another corporation owned by the same shareholder.

When the stockholders of a corporation liquidate it and transfer the assets to another corporation which continues the business under the same ownership, the effect of the transactions is a reorganization.[2] The liquidation may not be considered an isolated transaction, but must be viewed together with the related transfer to the continuing corporation.[3] It is not essential that the properties be transferred directly by the liquidating corpora-

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[1] SEC. 337. GAIN OR LOSS ON SALES OR EXCHANGES IN CONNECTION WITH CERTAIN LIQUIDATIONS.

(a) General Rule.—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

[2] *David T. Grubbs*, 39 T. C. 42 (1962); *John G. Moffatt*, 42 T. C. 558 (1964), affd. 363 F. 2d 262 (C. A. 9, 1966); *John Armour, Inc.*, 43 T. C. 295 (1964); *Survanat* v. *Commissioner*, 162 F. 2d 753 (C. A. 8, 1947), affirming on this point 5 T. C. 665 (1945).

[3] *Helvering* v. *Limestone Co.*, 315 U. S. 179 (1942); *Davant* v. *Commissioner*, 366 F. 2d 874 (C. A. 5, 1966), affirming on this point 43 T. C. 540 (1965).

tion to the continuing one; the transfer may be through the stockholders as a conduit.[7]

Under section 368(a)(1)(D), the term "reorganization" includes a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders, is in control of the corporation to which the assets are transferred. Here, all the assets of Hevaloid were transferred to Suvretta, and Abegg, the shareholder of the transferor, was in control of Suvretta.

The statute further requires that stock of the corporation receiving the assets be distributed in a transaction which qualifies under sections 354, 355, or 356. The relevant provision here is section 354 which provides in subsection (a) for non-recognition of gain or loss, and in subsection (b) provides that subsection (a) shall not apply to an exchange in pursuance of a plan of reorganization under section 368(a)(1)(D) unless the corporation to which the assets are transferred acquires substantially all the assets of the transferor and the stock and properties received by the transferor are distributed in pursuance of the plan of reorganization. Here Suvretta received all the stocks and properties and at least an equal amount of the cash held by Hevaloid, and Suvretta's stock was all distributed to Abegg in pursuance of the plan of reorganization. The plan need not be in writing and a reorganization may include a liquidation of a corporation a party to it. *Lewis* v. *Commissioner*, 176 F. 2d 646 (C. A. 1, 1949), affirming 10 T. C. 1080.

As the court pointed out in *Davant* v. *Commissioner*, 366 F. 2d 874 (C. A. 5, 1966), the intention of Congress in

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[7] *Richard H. Survant*, 5 T. C. 665, 672 (1945), affd. on this point 162 F. 2d 753 (C. A. 8, 1947); *Mark Klceden*, 38 B.T.A. 821 (1938); *Ethel K. Lesser*, 26 T. C. 306 (1956); *Bard-Parker Co.* v. *Commissioner*, 218 F. 2d 52 (C. A. 2, 1954), affirming 18 T. C. 1255 (1952).

enacting the complete liquidation provisions contemplated that the operating assets would no longer be used by the stockholders to carry on the business as a corporation. Here the assets of Hevaloid are being used by Crosta in the same way as formerly used by Hevaloid. The fact that both were personal holding companies does not require a different conclusion. *Estate of Elise W. Hill*, 10 T. C. 1090, 1095 (1948).

Although Abegg intended to liquidate Hevaloid, he also intended to have the assets which it held transferred to another corporation, Suvretta, which would hold them and continue to manage them as investments. This is a classic example of reorganization as opposed to liquidation. A different situation was involved in *Pridemark, Inc.* v. *Commissioner*, 345 F. 2d 35 (C. A. 4, 1965), reversing in part and affirming in part 42 T. C. 510 (1964), relied upon by the petitioners. The Court of Appeals there expressed the view that to have a liquidation, the corporation must have ceased to be a going concern, or if the enterprise is continued in corporate form, the stockholder must have disassociated himself from it. In the present case the same assets were transferred to a new corporation owned by the same stockholder who was not disassociated from the enterprise of managing the investment of those assets. See also *James Armour, Inc.*, 43 T. C. 295 (1964), and *Ralph C. Wilson, Sr.*, 46 T. C. 334 (1966).

The respondent correctly determined that a reorganization was effected under section 368(a)(1)(D).

Since a reorganization occurred, the tax consequences are to be governed by the provisions of the Code dealing with reorganizations, sections 354 to 368, and not those dealing with liquidations, sections 331 to 346. *Commissioner* v. *Morgan*, 288 F. 2d 676 (C. A. 3, 1961), reversing 33 T. C. 30 (1959), certiorari denied 368 U. S. 836, rehearing denied 369 U. S. 826; *Liddon* v. *Commissioner*, 230 F. 2d 304 (C. A.

6, 1956); affirming on this point 22 T. C. 1220, certiorari denied 352 U. S. 824; *David T. Grubbs*, 39 T. C. 42 (1962). It follows that Hevaloid's gain of $932,701.27 realized upon sales of stock is not subject to nonrecognition under section 337 as in a liquidation, but is to be recognized under section 1002.[9]

Respondent contends further that if there was a reorganization under section 368(a)(1)(D), Hevaloid in effect transferred all its assets to Suvretta in exchange for Suvretta stock and, as a result, Hevaloid realized a gain of $267,244.46 with respect to the assets except cash and the Perosa receivable. Ordinarily this gain would be subject to nonrecognition under section 361(a),[10] but since no ruling under section 367[11] was requested, this gain must be recognized. *Texas-Canadian Oil Corporation, Ltd.*, 44 B.T.A. 913 (1941).

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[9] SEC. 1002. RECOGNITION OF GAIN OR LOSS.

Except as otherwise provided in this subtitle, on the sale or exchange of property the entire amount of the gain or loss, determined under section 1001, shall be recognized.

[10] SEC. 361. NONRECOGNITION OF GAIN OR LOSS TO CORPORATIONS.

(a) General Rule.—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

[11] SEC. 367. FOREIGN CORPORATIONS.

In determining the extent to which gain shall be recognized in the case of any of the exchanges described in sections 332, 351, 354, 355, 356, or 361, a foreign corporation shall not be considered as a corporation unless, before such exchange, it has been established to the satisfaction of the Secretary or his delegate that such exchange is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes. For purposes of this section, any distribution described in section 355 (or so much of section 356 as relates to section 355) shall be treated as an exchange whether or not it is an exchange.

The substance of the present section 367 was first enacted as section 112(k) of the Revenue Act of 1932. The purpose of this provision was explained in S. Rept. No. 665, 72d Cong., 1st Sess., 1939-1 C. B. (Part 1) 515, as follows:

> Property may be transferred to foreign corporations without recognition of gain under the exchange and reorganization sections of the existing law. This constitutes a serious loophole for avoidance of taxes. Taxpayers having large unrealized profits in securities may transfer such securities to corporations organized in countries imposing no tax upon the sale of capital assets. Then, by subsequent sale of these assets in the foreign country, the entire tax upon the capital gain is avoided. For example, A, an American citizen, owns 100,000 shares of stock in Corporation X, which originally cost him $1,000,000 but now has a market value of $10,000,000. Instead of selling the stock outright A organizes a corporation under the laws of Canada to which he transfers the 100,000 shares of stock in exchange for the entire capital stock of the Canadian company. This transaction is a nontaxable exchange. The Canadian corporation sells the stock of Corporation X for $10,000,000 in cash. The latter transaction is exempt from tax under the Canadian law and is not taxable as United States income under the present law. The Canadian corporation organizes Corporation Y under the laws of the United States and transfers the $10,000,000 cash received upon the sale of corporation X's stock in exchange for the entire capital stock of Y. The Canadian corporation then distributes the stock of Y to A in connection with a reorganization. By this series of transactions, A has had the stock of X converted into cash and now has it in complete control.
>
> While it is probable that the courts will not hold all transactions of this nature to be tax-free exchanges, the committee is convinced that the existing law may

afford opportunity for substantial tax avoidance. To prevent this avoidance the bill withdraws the transaction from the operation of the nonrecognition sections where a foreign corporation is a party to the transaction, unless prior to the exchange the Commissioner is satisfied that the transaction is not in pursuance of a plan having as one of its principal purposes the avoidance of taxes. It will be noted that under this provision a taxpayer acting in good faith can ascertain prior to the transaction, by submitting his plan to the Commissioner, that it will not be taxable if carried out in accordance with the plan. * * *

We sustain respondent's determination of the deficiency against Hevaloid.

We next consider whether Cresta is liable as a transferee for this deficiency. Cresta contends that it is not liable as a transferee of assets of Hevaloid for the deficiency. It says that Abegg, not Cresta, is the transferee and that Cresta is not liable as a transferee of a transferee since respondent has not proved that Abegg was insolvent and unable to pay the deficiencies. It alleges that Abegg was able and willing to pay any liability of Hevaloid for taxes and that respondent has determined this deficiency against the wrong party as transferee. It is stipulated that throughout the year 1957 Abegg's United States assets exceeded his liabilities by at least $2,000,000.

Where the assets of a corporation have been transferred to another for stock which is issued to the stockholders of the transferor, leaving the transferor without any property to meet its tax liabilities, the respondent may have a choice of proceeding against the assets in the hands of the transferee corporation or the stock in the hands of the stockholders, or against both.

In *Woodley Petroleum Co.*, 16 B.T.A. 253 (1929), deficiencies in tax were determined against Old Farmers Co.

The assets of the taxpayer were purchased by Woodley for its stock which was distributed directly to the stockholders of the taxpayer. Old Farmers was dissolved. The Commissioner proceeded against both the stockholders and Woodley. We sustained the determination against Woodley and withheld decision as to the liabilities of the stockholders.

In *Warner Collieries Co. of Delaware*, 36 B.T.A. 54 (1937), affirmed per curiam 107 F. 2d 1023 (C. A. 6, 1939), the petitioner transferee contended that the tax should be collected from the transferor's stockholders to whom the petitioner's stock had been distributed. We there held that respondent is not precluded from proceeding against the transferee of the assets of the transferor even if other assets distributed to the stockholders were subject to a like process.

In *Bates Motor Transport Lines, Inc.*, 17 T. C. 151 (1951), affd. 200 F. 2d 20 (C. A. 7, 1952), the respondent determined deficiencies against a transferor and notified the transferee corporation and its sole stockholder, who had been the principal stockholder of the transferor, that each was liable as transferee for such deficiencies. The transferee corporation admitted liability as a transferee. The stockholder denied such liability, claiming that no assets were transferred to him and that his exchange of stock in the transferor for stock in the transferee afforded no basis for a conclusion that he was a transferee. We sustained the determination that the stockholder, also, was liable as a transferee. See, also, *Concrete Industries Co.*, 19 B.T.A. 655 (1930), and *Fairless* v. *Commissioner*, 67 F. 2d 475, 477 (C. A. 6, 1933), affirming 19 B.T.A. 304 (1930), where, in holding shareholders liable as transferees, the court observed that the transferee corporation might also be held liable.

The matter of Abegg's solvency and his ability and alleged willingness to pay any tax liability of Hevaloid is

immaterial. In our view he served as a conduit for the transfer of Hevaloid's assets to Suvretta. Aside from the cash, there were identified stocks with a stipulated fair market value of $435,239.05 owned by Hevaloid which were received by Suvretta in exchange for its stock. The tax deficiency was less than this amount. The respondent may follow these assets into the hands of the transferee, Suvretta (now Cresta), and is not obliged to examine the solvency of Abegg or to proceed against him before proceeding against Cresta. We conclude that Cresta is liable as a transferee of Hevaloid for the deficiencies determined against Hevaloid.

In docket No. 1570-62, respondent determined that Abegg realized long-term capital gains in the amount of $64,434.88 in 1958 from the transfer of securities to Cresta. The notice of deficiency stated:

> You were present in the United States for more than 90 days during the taxable year. On February 20 [sic], 1958 you contributed various securities to Cresta Corporation, S.A., a foreign corporation of which you are the sole shareholder. This is treated as an exchange. You did not request clearance under section 367 of the Internal Revenue Code of 1954 prior to the exchange. The gains realized as shown below are recognized gains taxable to you under the provisions of section 871(a)(2) and section 871(b) of the Internal Revenue Code of 1954.

The gains were computed on the transfer of 50,680 shares of Brazos River Gas Co. and 4,250 shares of General American Oil Co., the fair market values of which were in excess of their adjusted bases. The stipulated facts show that at the same time Abegg also transferred 12,650 shares of Magma Copper Co. which had a fair market value considerably less than the adjusted basis to Abegg. The adjusted bases of the three stocks taken together was $1,448,473.62 and the stipulated fair market value was $661,013, or less than one-half of the stipulated bases.

Respondent contends that the transfer in question was "in effect" an exchange under section 351" and, accordingly, that the gain realized upon the transfer of the appreciated stocks (Brazos River Gas Company and General American Oil Company) aggregating $64,434.88, is to be recognized under sections 1002 and 371(a)(2)(B) because section 367 was not complied with, and the loss realized upon the transfer of the depreciated stock (Magma Copper Company) in the amount of $851,895.50, is not to be recognized inasmuch as section 367 provides for the recognition of "gain" and not "net gain."

Petitioner Abegg contends that the transfer in question did not constitute an exchange within the meaning of section 351 and consequently that section 367 is not applicable. He further argues that if the transfer is held to be an exchange under sections 351 and 367, he realized no "gain" by reason of the transfer of the stocks but rather a loss in the amount of $787,460.62, and hence there was no gain to be recognized under section 367.

"SEC. 351. TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR.

(a) General Rule.—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation. For purposes of this section, stock or securities issued for services shall not be considered as issued in return for property.

(b) Receipt of Property.—If subsection (a) would apply to a exchange but for the fact that there is received, in addition to the stock or securities permitted to be received under subsection (a), other property or money, then—

(1) gain (if any) to such recipient shall be recognized, but not in excess of—

(A) the amount of money received, plus

(B) the fair market value of such other property received; and

(2) no loss to such recipient shall be recognized.

The basic question is whether the transfer by Abegg to Suvretta on February 26, 1958 is *to be treated* as an exchange of property for stock within the meaning of section 351, notwithstanding, as stipulated by the parties, "Suvretta did not issue its stock or any other property to Abegg in exchange therefor" and the transfer of the stocks in question was "recorded on the books of Suvretta as a contribution to capital."

It is apparently respondent's position that the fact that no additional stock of Suvretta (Cresta) was issued to Abegg on the occasion of his transfer is immaterial inasmuch as Abegg already owned all of the outstanding stock of Suvretta and the issuance of additional stock would have been a useless gesture. In support of his position, respondent refers to Rev. Rul. 64-155, C. B. 1964-1, page 138,[12] and the cases of *King* v. *United States*, 79 F. 2d 453 (C. A. 4, 1935), and *Commissioner* v. *Morgan*, *supra*, cited therein. The Revenue Ruling is, of course, not controlling on us here, *W. Palmer Dixon*, 381 U. S. 68, 73 (1965); *D. B. Anders*, 48 T. C. 815 (1967), and the *King* and *Morgan* cases are distinguishable.

In *Commissioner* v. *Morgan*, *supra*, the crucial question was whether the transfer by one corporation of all its operating assets to another corporation constituted a complete liquidation under section 115(c) of the Internal Rev-

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[12] Rev. Rul. 64-155, C. B. 1964-1, page 138. Foreign corporations.

X, a domestic corporation, proposes to contribute appreciated property to Y, an existing wholly-owned foreign subsidiary. Although X will not receive any additional Y shares, the transaction will be considered an exchange of property for stock described in section 351 of the Internal Revenue Code of 11954. Compare *King* v. *United States*, 10 Fed. Supp. 206 (1935), affirmed 79 Fed. (2d) 453 (1935); *Commissioner* v. *Walter L. Morgan, et ux.*, 288 Fed. (2d) 676 (1961), certiorari denied 368 U. S. 836 (1962). Consequently, section 367 of the Code will be applicable and gain recognized to X corporation to the extent of the appreciation in value of the contributed property unless it is previously established that the proposed transaction is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes.

enue Code of 1939, or a reorganization under section 112(b)(3) and (c)(1) of the 1939 Code, where there had been no actual exchange of stock and all the stock of both the transferor and the transferee corporations were owned by the same person. The United States Court of Appeals held that an actual physical exchange of stock was not necessary to the establishment of a reorganization where all of the stock of both the transferor corporation and the transferee corporation were owned by the same party. In *Morgan* the court was concerned with the question whether a transfer by a corporation constituted a liquidation or a reorganization; it was not concerned with the question whether an actual exchange of stock was essential to constitute a transfer by an individual such as we have here, under section 351.

King v. *United States, supra,* involved a question of basis under section 204(a)(2) and (8) of the Revenue Act of 1926.[13] In July 1921, Berliner, who then owned certain

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[13] BASIS FOR DETERMINING GAIN OR LOSS, DEPLETION, AND DEPRECIATION.

SEC. 204(a). The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * * * *

(2) If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift. * * *

* * * * * * *

(8) If the property (other than stock or securities in a corporation a party to a reorganization) was acquired after December 31, 1920, by a corporation by the issuance of its stock or securities in connection with a transaction described in paragraph (4) of subdivision (b) of section 203 (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money in addition to such stock or securities), then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made;

stock in both a British and an American corporation, organized a new corporation and transferred his British stock to it in exchange for substantially all of the stock of the new corporation. Within 30 days he also transferred his stock in the American corporation to the new corporation, without additional stock issuance or other consideration. The reason the American stock was not transferred at the same time the British stock was transferred was not due to design but because the certificate for the American stock was not immediately at hand. The new corporation sold the American stock in 1927. It was subsequently dissolved and all its assets transferred to plaintiff. She paid the tax assessed against it and sued for a refund. Plaintiff claimed the stock in question represented *paid-in surplus* and the basis was the fair market value as of the date it was transferred to the new corporation. The Government claimed the transfer was in connection with a transaction described in section 203(b)(4) of the Revenue Act of 1926 (the predecessor of section 351 of the 1954 Code) and the basis was that of the transferor as provided by section 204(a)(8) of the Revenue Act of 1926.

The trial court expressed the view that, as applied in that case, the issuance of additional stock to one who already owned all of the stock of the transferee corporation was not material since the value of all the stock held by him would remain substantially the same irrespective of the mere number of shares, and that in a financial sense it would do no great violence to the statute *to treat* the transaction *in substance* as the issuance of securities for the property transferred. The court also found, however, that the failure to transfer the American stock at the same time the British stock was transferred was due to accident and not design, and that

> it is fairly inferable * * * that it was within the original contemplation of Berliner to transfer not only the stock in the British corporation but also that in the American corporation to his new family corporation

> when organized, and the stock that was issued to him therefor by the Virginia corporation was really intended to be for the stock shortly subsequently as well as that contemporaneously transferred.

The appellate court agreed this was a fair inference and necessarily followed from the facts admitted, but was also of the opinion the inference was not material to a proper decision of the issue involved, stating, in part:

> As was well reasoned by the judge below, the issuance of additional stock in the transferee corporation to the man who already owned all of the stock would in no way have affected the value of the stock already held by him, while owned by him, and the conclusion is inescapable that the transaction must be treated in substance as the issuance of securities for property transferred. * * *

Both courts referred to the legislative history of the statutes involved and the enactment of section 113(a)(8) of the Revenue Act of 1932 (the predecessor of section 362(a) of the 1954 Code), subsequent to the taxable year involved therein, as indicating the intention of Congress to impose the income tax on the whole of the profits arising after March 1, 1913, from the appreciated value of the property when sold, irrespective of the continuity of ownership when the latter was broken by transfers without consideration. Under these statutes (sections 113(a)(8) and 362(a), *ibid.*), the basis would be that of the transferor whether paid-in surplus, a contribution to capital, or transferred in connection with a transaction described in section 351.

In our opinion neither the *Morgan* nor the *King* case is controlling on the issue presented here. We are not concerned with whether the transfer of the stock in question constituted a reorganization or with a question of basis. The question here is whether there was in fact an "ex-

change" as provided by section 351. We do not think there was. The stock transferred by Abegg to Suvretta on February 26, 1958, was not a part of the assets transferred by Hevaloid to Abegg and by Abegg to Suvretta in May 1957. It was never owned by Hevaloid but was the separate property of Abegg. It was transferred nine months after the reorganization between Hevaloid and Suvretta had taken place and there is not the slightest evidence that the transfer of the stock here in question was intended to be included in that reorganization. We recognize that where, as in the *King* case, the subsequent "contribution to capital" is a part of the original plan section 351 may be applicable, but such is not the case here. In our opinion, there is no justification to extend the rulings in the *Morgan* and *King* cases to the facts of the present case, contrary to the plain and unambiguous language of section 351.

We hold that the securities transferred by Abegg to Suvretta in February 1958 constituted a contribution to capital and that section 351 is not applicable. In view of the foregoing, we need not determine whether, if section 351 were applicable, Abegg would be taxable on the gross gains without benefit of offsetting losses on the securities transferred.

Decisions will be entered under Rule 50.

Order of the United States Court of Appeals for the Second Circuit

UNITED COURT OF APPEALS
SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the fourteenth day of July one thousand nine hundred and seventy.

Present:

HON. STERRY R. WATERMAN,
HON. HENRY J. FRIENDLY,
HON. PAUL R. HAYS,
Circuit Judges

CRESTA CORPORATION, S.A., Transferee,

Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

APPEAL FROM THE TAX COURT OF THE UNITED STATES

This cause came on to be heard on the transcript of record from the Tax Court of the United States, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged and decreed that the order of said The Tax Court of the United States be and it hereby is affirmed without costs in accordance with the opinion of this court.

A. DAVID FUSARO
Clerk

Decision of the Tax Court of the United States

TAX COURT OF THE UNITED STATES
Docket No. 1571-62

CRESTA CORPORATION, S.A., Transferee,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Pursuant to the Opinion of the Court filed April 25, 1968, and incorporating herein the facts recited in the respondent's computation as the findings of the Court, it is

ORDERED AND DECIDED: That the following statement shows the liability due from the petitioner as transferee of asset of Hevaloid Corporation, transferor, for income tax of the transferor and interest thereon for the taxable year 1957:

Liability for:	
Income tax of the transferor	$296,952.18
Interest from March 15, 1958 to March 16, 1962	71,317.34
Total Liability	$368,269.52
Amount Paid March 16, 1962	296,952.18
Liability to be paid	$ 71,317.34

(Signed) J. GREGORY BRUCE,
Judge.

Entered: July 7, 1969

In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 837.

CRESTA CORPORATION, S.A., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (Pet. App. 24a–54a) are reported at 50 T.C. 145. The opinion of the court of appeals (Pet. App. 4a–23a) is reported at 429 F. 2d 1209.

JURISDICTION

The judgment of the court of appeals was entered on July 14, 1970 (Pet. App. 55a). The petition for a writ of certiorari was filed on October 12, 1970. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the liquidation and distribution of the assets of a personal holding company to its sole share-

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holder followed by his retransfer of these assets to a second wholly owned personal holding company constituted a corporate reorganization described in Section 368(a)(1)(D) of the Internal Revenue Code.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Section 368(a)(1) of the Internal Revenue Code and the accompanying Regulations are set forth in the Appendix to the petition (pp. 1a–3a).

STATEMENT

In 1938, Werner Abegg ("Abegg"), a citizen and resident of Switzerland at all times here pertinent, organized the Hevaloid Corporation ("Hevaloid"), a Delaware corporation, to hold and exploit certain patents. In connection with this business, Hevaloid leased certain machinery. Abegg was Hevaloid's sole shareholder. During 1957, the taxable year in suit, Robert A. Cavin ("Cavin"), a close personal friend and investment adviser to Abegg, was the president and sole employee of Hevaloid.

Abegg organized the Cresta Corporation, S.A. ("Cresta"), a Panamanian corporation, in 1941, and owned all of its capital stock. Cresta was inactive from the time of its formation until 1957. (Pet. App. 26a–27a.)

Hevaloid's patents expired in 1955 and, in the same year, it sold the related machinery. Thereafter, during the remainder of its corporate existence, it was a personal holding company engaged solely in the acquisition, holding and disposition of investment assets

(stock and securities, receivables and certain rights in a motion picture). (Pet. App. 28a, 35a.)

On March 28, 1957, Hevaloid's board of directors adopted a plan of complete liquidation and dissolution. In pursuance of this plan, some of its assets were sold, resulting in a gain of $932,701.27. Hevaloid claimed entitlement to nonrecognition of this gain under Section 337 of the Internal Revenue Code, which provides for nonrecognition treatment on the sale or exchange of corporate property made within 12 months after adoption of a plan of complete liquidation. By the end of 1957, Hevaloid had completely liquidated by distributing the cash and unsold assets to Abegg. (Pet. App. 28a–30a.)

Almost immediately after receiving these assets, Abegg transferred them to Cresta, his previously inactive corporation. Cavin was hired by Cresta to serve in the same capacity he had previously served Hevaloid. (Pet. App. 27a.) No determination or ruling under Section 367 of the Internal Revenue Code was ever requested as to any of the above-described transactions. (Pet. App. 35a.) That section provides that gain realized upon the transfer of assets to a foreign corporation is to be recognized unless, prior to the transfer, the Commissioner of Internal Revenue determines that the transfer is not in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes.

Viewing these transactions as a whole and applying the liquidation-reincorporation doctrine in order to

tax their substance rather than their form, the Tax Court held that there had been a "reorganization" as defined in Section 368(a)(1)(D), whereby the assets of Hevaloid were transferred to Cresta through Abegg, acting as a mere conduit. Having determined that Hevaloid's business continued in modified form through a reorganization, the Tax Court held that Hevaloid did not qualify for nonrecognition treatment under Section 337 on sales of its assets prior to the transfers, and that, since Hevaloid as the real transferor of assets to Cresta had obtained no Section 367 determination, gain must be recognized on the transfers. The Tax Court further held that Cresta, as the transferee of Hevaloid, was liable for the taxes thus due from Hevaloid. On appeal, the Second Circuit affirmed.

ARGUMENT

The decision below is correct. There is no conflict or other reason for further review.

Petitioner objects to the holding that the transactions constituted a reorganization for federal tax purposes. It does not contest that substance over form (the liquidation-reincorporation doctrine) controls whether the statutory requirements of a Section 368(a)(1)(D) reorganization (hereinafter "D" reorganization) are met. But it urges that two requirements of a reorganization—business purpose and continuity of business enterprise—are absent.

1. Petitioner asserts that the requirement of *Gregory* v. *Helvering*, 293 U.S. 465, that a corporation emerging from a reorganization have a business pur-

pose, is satisfied only if the corporation conducts an active business, as opposed to a passive one such as the holding of investment assets. Accordingly, it argues that a personal holding company does not satisfy the "business purpose" requirement. This argument is incorrect.

In *Gregory* v. *Helvering, supra,* certain corporate assets were transferred in a transaction which would now resemble a divisive "D" reorganization. The corporation emerging from the transaction was a personal holding company, and immediately thereafter was liquidated. Although the transaction was molded so as to conform to the technical "reorganization" requirements, it was undertaken solely to transform ordinary dividend income into capital gain through the ephemeral existence of the emerging corporation. This Court held that since the latter served no business purpose other than tax avoidance, it should be ignored for tax purposes. See *Moline Properties, Inc.* v. *Commissioner,* 319 U.S. 436, 438; *Commissioner* v. *National Carbide Corp.,* 167 F. 2d 304, 306 (C.A. 2), affirmed, 336 U.S. 422; *National Investors Corp.* v. *Hoey,* 144 F. 2d 466 (C.A. 2).

The rationale of *Gregory* does not apply where the emerging corporation, be it a holding company or otherwise, continues in existence after the reorganization and engages in business. See *Chisholm* v. *Commissioner,* 79 F. 2d 14, 15 (C.A. 2), certiorari denied, 296 U.S. 641; *Lea* v. *Commissioner,* 96 F. 2d 55 (C.A. 2). Indeed, if the emerging corporation carries on any legitimate function, its existence is to be recognized for tax purposes. See *Commissioner* v. *National Carbide Corp., supra,* p. 306; *Electrical Securities Corp.* v.

Commissioner, 92 F. 2d 593, 595 (C.A. 2); *National Investors Corp.* v. *Hoey, supra*, pp. 467–468; *Moline Properties, Inc., supra; Paymer* v. *Commissioner*, 150 F. 2d 334 (C.A. 2). There is thus no conflict with *Gregory*. Where, as here, a holding company, continues to engage in the disposition, acquisition, and holding of investments, the authorities uniformly hold that the "business purpose" requirement is met. See, *e.g.*, *Lea* v. *Commissioner, supra.*

2. Petitioner also urges (Pet. 9–11) that there was no reorganization because there was no continuity of business enterprise common to Hevaloid and Cresta. See Treasury Regulations on Income Tax (1954 Code), Sec. 1.368–1(b). In so arguing petitioner mistakenly assumes that the "continuity of business enterprise" test is not met if the surviving corporation does not conduct the same business as the old corporation. This is not correct. The "continuity of the business enterprise" requirement is satisfied if a bona fide corporate entity—as opposed to a mere shell corporation devoid of business purpose—emerges from the reorganization in the conduct of *any* business enterprise. *Becher* v. *Commissioner*, 221 F. 2d 252 (C.A. 2); *Bentsen* v. *Phinney*, 199 F. Supp. 363 (S.D. Tex.); *Pebble Springs Distilling Co.* v. *Commissioner*, 23 T.C. 196, affirmed, 231 F. 2d 288 (C.A. 7), certiorari denied, 352 U.S. 836. In Rev. Rul. 63–29, 1963–1 Cum. Bull. 77, for instance, the Commissioner conceded that a toy manufacturing corporation which emerged from a "C" reorganization as a corporation engaged in the steel distributing business fulfilled the "continuity of the business enterprise" requirement and

thus was entitled to the nonrecognition benefits of the reorganization provisions.

Moreover, in this instance the Tax Court found that Hevaloid had abandoned its patent operations, that it had been operated solely as a personal holding company for a period of over 15 months immediately preceding the reorganization, and that it so characterized itself on its income tax returns (Pet. App. 28a, 35a, 39a). Accordingly, petitioner, which concededly was operated as a personal holding company, succeeded to the exact business in which Hevaloid had been engaged.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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